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MEMORANDUM
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TO: Docket Control 2007 JUL -2 P 3: 58

FROM: Ernest G. Johnson AZ CORP COMMISSION
Director DOCKET CONTROL
Utilities Division

DATE: July 2, 2007

RE: COMPLIANCE ITEM - FINAL SYSTEM IMPROVEMENT SURCHARGE
REPORT AND STAFF AUDIT IN THE MATTER OF EMERGENCY
INTERIM RATE RELIEF FOR:

Miracle Valley Water System – Docket No. W-01646A-06-0010
Cochise Ranch Water System – Docket No. W-01868A-06-0010
Horseshoe Ranch Water System – Docket No. W-02235A-06-0010
Crystal Water System – Docket No. W-02316A-06-0010
Mustang Water System – Docket No. W-02230A-06-0010
Coronado Estates Water System Docket No. W-01629A-06-0010
Sierra Sunset Water System – Docket No. W-02240A-06-0010

Arizona Corporation Commission

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Introduction

In Decision No. 68667 (April 20, 2006), the Arizona Corporation Commission (“Commission”) approved emergency interim rate relief for Miracle Valley Water Company, Inc., Cochise Water Company, Horseshoe Ranch Water Company, Crystal Water Company, Mustang Water Company, Sierra Sunset Water Company, and Coronado Estates Water Company, previously owned by Johnny A. McLain (“collectively the McLain Systems”).

The relief was a System Improvement Surcharge (“SIS”) of \$9.00 per month per customer. The purpose of the SIS was to make improvements to the seven water systems because they are old and badly in need of repairs and structural improvements. The systems were operated for many years with minimal repairs and improvements.

That Decision requires Arizona Small Utilities Association (“ASUA”) or any future owner to maintain a separate bank account in which it must deposit and withdraw all funds received pursuant to the SIS, also file monthly reports with Docket Control, in Docket No. W-01642A-06-0010, as a compliance item in this matter, detailing how the SIS funds were spent, on which of the seven systems the money was spent and a report of the remaining amounts due on accounts payable. The Decision required Staff to conduct an audit of the SIS funds expenditures on an annual basis beginning April 1, 2007. A Notice of Filing Staff’s Annual System Improvements Surcharge Audit was filed requiring that Staff conduct a final audit by July 1, 2007, encompassing the period from the inception of the SIS to the closing of the sale of the

systems to be filed in the consolidated docket with Docket Control. In addition, the audit will include an on-site visit to review the records and infrastructure. Staff notes that the SIS fund automatically expired on or about April 1, 2007, when the applicant closed on the purchase of the McLain systems.

The McLain Systems were operated by an interim manager, ASUA from May 12, 2006, through September 18, 2006. ASUA did some repairs to the systems to keep the systems working to provide water to the customers. Also ASUA did the monthly billings to the customers for the SIS and monthly water usage and collection of the SIS and the water revenue.

Algonquin Water Resources Inc. ("Algonquin" or "Company") became the interim manager for the McLain systems on September 18, 2006. Algonquin operated the systems under two other Companies, Northern Sunrise Water Company and Southern Sunrise Water Company, and divided the seven water systems between these two Companies.

ASUA provided Algonquin with historical billing information and Algonquin prepared the October 2006 customer billing. ASUA did not provide any other information to Algonquin as to what improvements were made, or transfer any unused SIS funds if any, or information regarding the remaining accounts payable. These two Companies did the necessary repairs to keep the water systems working and to provide water to the customers.

Algonquin purchased the systems out of bankruptcy and became the owner of the McLain Systems on February 19, 2007. The proposed sale has been approved by the Commission in Decision No. 68826. Decision No. 68826 also requires that the SIS terminate the first day of the month after Algonquin has filed notification that the sale of the McLain water systems has closed.

Compliance Audit Results

Staff has conducted three prior audits of the SIS funds and expenditures for the periods from May 12, 2006 through June 19, 2006, May 12, 2006 through July 21, 2006 and May 12, 2006, through September 21, 2006, prior to this final audit.

The prior audits findings are docketed with Docket Control. ASUA was the interim manager during the period of May 12, 2006, through September 18, 2006. The amount collected through September 21, 2006, was \$60,048.07. Of the total received, \$13,525.94 was received from the Arizona Water Infrastructure Funding Authority ("WIFA") for emergency well repairs and the balance of \$46,522.13 from the SIS. Disbursements from the SIS funds through September 21, 2006, totaled \$51,366.18 and included \$20,364.89 for payment of accounts payable liabilities. Additional disbursements were made after September 21, 2006, in the amount \$8,682 on accounts payable. It was noted that two minor incorrect disbursements were made from the SIS account and these were corrected. All SIS funds were properly utilized and used.

During the audit period of September 22, 2006, through March 31, 2007, Algonquin was the interim manager.

Staff sent two separate data requests to the Company, held a meeting with Algonquin to clarify the information received in response to the two data requests and visited the Algonquin office. The Algonquin workflow, billing process, customer service, accounting procedures and check and balances were reviewed by Staff during the visit to the Algonquin office. Staff determined the total amount of SIS funds from customer counts for each water system. Staff reviewed the general ledger expense accounts and inspected invoices for SIS expenditures.

An on-site compliance audit of the accounting records was conducted on June 18, 2007. An on-site compliance field inspection audit of the infrastructure of the seven water systems was conducted on June 24, 2007, by Staff Engineer, Marlin Scott, Jr.

During this final audit, it was determined that Algonquin did not comply with the requirements of Decision No. 68667. Algonquin did not maintain a separate bank account for the SIS funds, or file monthly reports with Docket Control on Docket No. W-01642A-06-0010 as a compliance item detailing how the SIS funds were spent, on which of the seven systems the money was spent, and a report of the remaining amounts due on accounts payable.

Staff estimated the amount of SIS funds by using the number of customers in each system and multiplying that number by the monthly SIS, arriving at an estimated amount of SIS collected for each water system during this period or a total of \$77,544.

The Company did not maintain separate expense accounts for each water system or have the invoices for purchases by system. Staff attempted to organize the invoices by systems. Many invoices could not be organized or associated with a particular water system so Staff characterized those as "system wide". Staff determined from the information submitted by the Company, that the total SIS expenditures were \$71,334 through March 31, 2007. In April 2007, additional SIS expenditures of \$6,210 were paid for services rendered in March 2007 for total expenditures of \$77,544. Algonquin stepped into the interim manager roll on short notice and believed, at the time, that its purchase of the McLain systems was imminent. It decided it prudent to establish a separate bank account for the McLain Systems cash, but didn't go to the time and expense (bank fee, etc.) of establishing 14 bank accounts for what it believed to be something that would last a couple of weeks. Unfortunately the purchase of the systems from the bankruptcy took a longer time than expected.

The total combined SIS revenue for ASUA and Algonquin is \$124,066.13 and the SIS expenditures were \$124,066.13. The accounts payable as of April 30, 2006, when ASUA became the interim manager was \$240,484.88. This accounts payable balance as of March 31, 2007, was determined to be zero. ASUA received from the Water Infrastructure Funding Authority \$13,525.94 for emergency well repairs to the Cochise Water System which was used for those repairs. See Schedule CRM-1.

Summary and Recommendations

Based on Staff's review of the available records, Algonquin's failure to comply with Decision No. 68667 notwithstanding, Staff found no evidence that funds were used improperly by Algonquin.

The Company is no longer collecting the SIS, therefore this is the final audit and Staff Report in this case.

EGJ:CRM:red

Originator: Charles R. Myhlhousen

Service list for: McLain Systems
Docket No.W-01646A-06-0010 et al

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Northern Sunrise Water Company
 Southern Sunrise Water company
 Systems Improvement Surcharge Audit
 Docket Nos.W-20453A-06-0247 & W-20454A-06-0248

Section 1

**SIS ACCOUNT ACTIVITY MAY 12, 2006
 THROUGH MARCH 31, 2007**

<u>Line No.</u>		<u>SIS Revenue By System</u>	<u>SIS Expenditures</u>	<u>Balance SIS Revenue</u>
1	Miracle Valley System	\$25,047.00	\$0.00	\$25,047.00
2	Cochise Water System	12,663.00	20,375.86	(7,712.86)
3	Horseshoe Water System	3,744.00	257.20	\$3,486.80
4	Crystal Water System	12,807.00	7,834.65	\$4,972.35
5	Mustang Water System	17,415.00	892.52	\$16,522.48
6	Coronado Estates Water System	4,230.00	1,745.17	\$2,484.83
	Sierra Water System	1,638.00	1,068.60	\$569.40
7	System Wide	46,522.13	91,892.13	(45,370.00)
8	TOTALS	<u>\$124,066.13</u>	<u>\$124,066.13</u>	<u>\$0.00</u>

Section 2**ACCOUNTS PAYABLE**

9	Accounts Payable April 30, 2006	\$240,484.88
10	Accounts Payable March 31, 2007	<u>\$0.00</u>

Section 3

**WATER INFRASTRUCTURE
 FUNDING AUTHORITY**

11	WIFA Loan	\$13,525.94
12	WIFA Loan expended for well repairs for	
13	Cochise Water System 7/26/2006	<u>13,525.94</u>
14	Balance of WIFA Loan	<u>\$0.00</u>